JUDGE SCHOFIELD

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CASHIERS

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

CNH DIVERSIFIED OPPORTUNITIES MASTER ACCOUNT, L.P.

Plaintiff,

v.

CHINA CARBON GRAPHITE GROUP, INC.

Defendant.

COMPLAINT

Plaintiff CNH Diversified Opportunities Master Account, L.P. ("CNH" or "Plaintiff"), by and through undersigned counsel, and for its Complaint against defendant China Carbon Graphite Group, Inc. ("China Carbon," "CHGI," or "Defendant"), hereby alleges as follows:

NATURE OF THE CASE

1. This action arises from China Carbon's *admitted* failure over a one-and-a-half-year period to redeem 300,000 shares of CHGI Series B Convertible Preferred Stock (the "Shares") that China Carbon sold to Plaintiff CNH in 2009 with the express

promise that the Shares would be mandatorily redeemed on the second anniversary of the transaction.

2. Since December 2011, China Carbon has been in blatant breach its contractual obligation to mandatorily redeem the Shares.

3. Indeed, China Carbon has *admitted* its duty to redeem the Shares in multiple filings with the United States Securities and Exchange Commission (the "SEC"). What it has refused to do, however, is simply to redeem the Shares.

4. China Carbon has now disclosed that it has dismissed its accounting firm, BDO China Dahua CPA Co., Ltd. ("BDO China Dahua"), after BDO China Dahua opined that China Carbon lacks the ability to continue as a going concern.

5. Plaintiff respectfully seeks, *inter alia*, specific performance of China Carbon's obligation to redeem the Shares, and preliminary and permanent injunctions, so that China Carbon's crisis does not prevent CNH from receiving the benefit of the mandatory redemption which China Carbon admits is long overdue.

THE PARTIES

6. Plaintiff CNH is a Cayman Islands entity with its principal place of business in Connecticut.

7. Defendant China Carbon has stated in filings with the SEC and elsewhere that it is a Nevada corporation which has its principal place of business in China.

8. The amount in controversy exceeds the sum of $75,000, exclusive of interest and costs.

9. This Court possesses subject-matter jurisdiction over this dispute under 28 U.S.C. § 1332.

10. Venue is proper in this Court pursuant to 28 U.S.C. § 1391 and pursuant to a choice-of-venue provision in Section 6(j) of the Subscription Agreement between the parties, a true and correct copy of which is annexed hereto as Exhibit A. The choice-of-venue provision provides that:

> Any legal suit, action or proceeding arising out of or relating to this Subscription Agreement or the transactions contemplated hereby shall be instituted exclusively in New York Supreme Court, County of New York, or in the United States District Court for the Southern District of New York. The parties hereto hereby: (i) waive any objection which they may now have or hereafter have to the venue of any such suit, action or proceeding, and (ii) irrevocably consent to the jurisdiction of the New York Supreme Court, County of New York, and the United States District Court for the Southern District of New York in any such suit, action or proceeding. The parties further agree to accept and acknowledge service of any and all process which may be served in any such suit, action or proceeding in the New York Supreme Court, County of New York, or in the United States District Court for the Southern District of New York and agree that service of process upon a party which is mailed by certified mail to such party's address shall be deemed in every respect effective service of process upon such party in any such suit, action or proceeding.

See Ex. A, at B-17.

FACTS COMMON TO ALL CLAIMS FOR RELIEF

The Transaction

11. On or about December 23, 2009, China Carbon and CNH entered into a Subscription Agreement.

12. Pursuant to the Subscription Agreement, on or about December 23, 2009 China Carbon issued to CNH 500,000 shares of Series B Convertible Preferred Stock in accordance with, and pursuant to, a Certificate of Designation filed with the

Nevada Secretary of State (the "Certificate of Designation," a true and correct copy of which is annexed hereto as Exhibit B).

13. China Carbon also issued certain warrants to CNH pursuant to the Subscription Agreement. The warrants are of no import to this action.

14. CNH paid China Carbon $600,000 pursuant to the Subscription Agreement.

15. The Subscription Agreement provides in part that it is governed by New York law with the exception of New York's choice-of-law provisions.

The Subscription Agreement and Certificate of Designation
Obligated China Carbon to Redeem the Shares Two Years After the Sale

16. Section 5(a) of the Certificate of Designation (the "Mandatory Redemption") provides in pertinent part:

> (a) The Series B Preferred Stock *shall be subject to mandatory redemption at the Redemption Price b*y the Corporation on the first to occur of (i) the day immediately prior to the effective date of a merger or consolidation of the Corporation into another corporation or a sale, lease, transfer or other disposition of all or substantially all of the assets of the Corporation in a transaction in which the proceeds of such sale are distributed to shareholders (a "**Deemed Liquidation Event**") or (ii) *second anniversary of the first issuance of Series B Preferred Stock.* The Redemption Price shall be $1.20, plus accrued but unpaid dividends to the date of payment. Such date is hereinafter referred to as the Mandatory Redemption Date. The Corporation shall give the holders of the Series B Preferred Stock notice of the mandatory redemption of the Series B Preferred Stock on the Mandatory Redemption Date not less than 20 days prior to the Mandatory Redemption Date. On or prior to the Mandatory Redemption Date, the Corporation shall provide the transfer agent for the Series B Preferred Stock or other paying agent with immediately available funds to pay the Redemption Price with respect to all shares of Series B Preferred Stock which are outstanding at the close of business on the business day preceding the Mandatory Redemption Date.

> Provided that (x) the Corporation shall have made the payment of the Redemption Price as required by this Section 5(a)[;] and (y) with respect to a mandatory redemption described in clause (ii) of the first sentence of this Section 5(a) only, the shares of Common Stock issuable upon conversion of the Series B Preferred Stock held by persons who are not affiliates of the Corporation, as defined in Rule 144 of the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended (the "**Securities Act**"), are not Restricted Shares, as defined in Section 5(b) of this Certificate of Designation, then from and after the Redemption Date, the holders of the Series B Preferred Stock shall have no further right to convert the Series B Preferred Stock or to have any voting or dividend rights with respect to the Series B Preferred Stock, and the only right of the holders of the Series B Preferred Stock shall be the right to receive the Redemption Price, without interest, upon presentation of the certificate for the shares of Series B Preferred Stock being redeemed, subject to the obligations of the Corporation with respect to applicable abandoned property laws. If the Corporation shall be unable to redeem the Series B Preferred Shares because shares issuable upon conversion of the Series B Preferred Stock that [sic] held by persons who are not affiliates would be Restricted Shares, the Corporation shall redeem the Series B Preferred Stock at the Redemption Price on 30 days' prior written notice as soon as practical either of the conditions in said Section 5(b) shall no longer be applicable.

Ex. B, at 6 (boldface emphasis in original).

17. Section 5 of the Certificate of Designation further provides in pertinent part:

> (b) Restricted Shares shall mean that both (i) the shares of Common Stock issuable upon conversion of the Series B Preferred Stock are not subject to a current and effective registration statement under the Securities Act and (ii) the shares of Common Stock issuable upon conversion of the Series B Preferred Stock, if held by persons who are not affiliates of the Corporation may not be sold pursuant to said Rule 144 or any substitute similar rule. The ownership of shares of Series B Preferred Stock by affiliates of the Corporation shall not affect the mandatory redemption or

> optional redemption of their Series B Preferred Stock if shares held by non-affiliates may be redeemed.

Ex. B, at 6-7.

18. The Mandatory Redemption was a material inducement to CNH to enter into the Subscription Agreement.

19. CNH would not have entered into the Subscription Agreement if the Mandatory Redemption obligation had not been included.

20. In other words, the absence of a requirement that China Carbon mandatorily redeem the shares of Series B Convertible Preferred Stock after two years would have been a deal-breaker for CNH.

China Carbon Registered the Underlying Shares

21. China Carbon filed a Form S-1 registration statement with the SEC on February 8, 2010 concerning "2,480,500 shares of our common stock issuable upon the conversion of the Series B Convertible Preferred Stock issued to the selling stockholders named in this prospectus." The assigned File Number of that Form S-1 registration statement was 333-164760. A true and correct copy of relevant excerpts of the February 8, 2010 Form S-1 is annexed hereto as Exhibit C.

22. Plaintiff CNH is listed as a "selling stockholder" in that Form S-1. Ex. C, at 44-46.

23. The SEC issued a Notice of Effectiveness of the February 8, 2010 registration statement, File Number 333-164760, on March 17, 2010. A true and correct copy of the March 17, 2010 Notice of Effectiveness is annexed hereto as Exhibit D.

China Carbon Filed a Form 8-K Acknowledging
Its Obligation to Redeem the Shares in December 2011

24. On December 28, 2009--less than a week signing the Subscription Agreement--China Carbon filed a Form 8-K with the SEC which disclosed in pertinent part that "[t]he Company is required to redeem the series B preferred stock at a redemption price of $1.20 per share plus accrued dividends on December 22, 2011." A true and correct copy of the December 28, 2009 Form 8-K is annexed hereto as Exhibit E.

CNH Converted 200,000 of the 500,000 Shares to Common Stock

25. CNH exercised its option to under Section 4 of the Certificate of Designation to convert 200,000 of the 500,000 shares of Series B Convertible Preferred Stock it originally purchased to common stock in CHGI.

26. On or about January 13, 2011, CNH converted 50,000 shares of Series B Convertible Preferred Stock to common stock.

27. On or about January 26, 2011, CNH converted 100,000 shares of Series B Convertible Preferred Stock to common stock.

28. On or about March 23, 2011, CNH converted 50,000 shares of Series B Convertible Preferred Stock to common stock.

29. CNH presently holds 300,000 shares of Series B Convertible Preferred Stock (the "Shares").

The Mandatory Redemption Became Due in December 2011,
But China Carbon Took No Action

30. The Certificate of Designation clearly set forth China Carbon's obligations on the two-year anniversary of the issuance of the Shares.

31. The Certificate of Designation obligated China Carbon to "give the holders of the Series B Preferred Stock notice of the mandatory redemption of the Series B Preferred Stock on the Mandatory Redemption Date not less than 20 days prior to the Mandatory Redemption Date." See Ex. B, at 6.

32. China Carbon failed to "give the holders of the Series B Preferred Stock notice of the mandatory redemption of the Series B Preferred Stock on the Mandatory Redemption Date not less than 20 days prior to the Mandatory Redemption Date."

33. The Certificate of Designation obligated China Carbon to, "[o]n or prior to the Mandatory Redemption Date . . . provide the transfer agent for the Series B Preferred Stock or other paying agent with immediately available funds to pay the Redemption Price with respect to all shares of Series B Preferred Stock which are outstanding at the close of business on the business day preceding the Mandatory Redemption Date." See Ex. B, at 6.

34. China Carbon failed to "[o]n or prior to the Mandatory Redemption Date . . . provide the transfer agent for the Series B Preferred Stock or other paying agent with immediately available funds to pay the Redemption Price with respect to all shares of Series B Preferred Stock which are outstanding at the close of business on the business day preceding the Mandatory Redemption Date."

35. There was, and is, no valid justification for China Carbon's failures to perform its obligations under Section 5(a) of the Certificate of Designation on the second anniversary of the issuance of the Shares.

36. In December 2011, the Shares had been held by CNH for approximately two years, and thus the Shares were saleable under Rule 144.

37. CNH has never been an affiliate of China Carbon.

38. The shares of CHGI common stock issuable upon conversion of the Series B Preferred Stock were subject to a current and effective registration statement under the Securities Act in December 2011, and had been since at least March 2010, and remain so now.

39. Thus, China Carbon's failure to effect the Mandatory Redemption on the second anniversary of the issuance of the Shares constitutes breach of contract.

CNH Notified China Carbon of Its Breach
Of Its Obligation to Effect the Mandatory Redemption

40. In a letter delivered to China Carbon on or about October 12, 2012 (the "First Notice of Breach," a true and correct copy of which is annexed hereto as Exhibit F), CNH stated in pertinent part that:

> Pursuant to the Subscription Agreement, the Company issued shares to the [CNH] of Series B Preferred Stock (the "**Shares**") on or about December 22, 2009. Pursuant to, and in accordance with, Section 5(a) of the Certificate of Designation, the Company was required to redeem the Shares on December 22, 2011, and the Company has failed to effect such redemption. The failure by the Company to comply with the terms of Section 5(a) of the Certificate of Designation

> constitutes breaches by the Company of its obligations thereunder.

Ex. F hereto (emphasis in original).

41. China Carbon made no response to the First Notice of Breach.

42. However, subsequent to the First Notice of Breach, China Carbon has made multiple SEC filings in which it acknowledged its contractual obligation to effect the Mandatory Redemption.

43. For example, on May 15, 2013, China Carbon filed a Form 10-Q, in which it stated in part that that "The remaining 300,000 shares of Series B Preferred Stock are redeemable by the holder . . . ." A true and correct copy of relevant excerpts of the May 15, 2013 Form 10-Q is annexed hereto as Exhibit G.

The Current Redemption Price is $440,760

44. Pursuant to Section 5(a) of the Certificate of Designation, "[t]he Redemption Price shall be $1.20, plus accrued but unpaid dividends to the date of payment." Ex. B at 6.

45. Pursuant to Section 2 of the Certificate of Designation (Ex. B hereto),

> [t]he holders of the Series B Preferred Stock shall be entitled to receive, out of funds of this Corporation legally available therefor, a dividend per share of Series B Preferred Stock at the rate of $0.072 per annum before dividends are payable with respect to any shares of Common Stock or any shares of any other class or series of capital stock of the Corporation which is junior to the Series B Preferred Stock as to dividends. The dividend shall be payable in quarterly installments of $0.018 per share of Series B Preferred Stock on the first day of April, July, October and January, commencing on April 1, 2010 (each, a "Dividend Payment Date") to holders of record on the fifteenth day of the previous month; provided, however, that the first dividend payment on April 1, 2010 shall accrue with respect to each share of

> Series B Preferred Stock at the annual rate of $0.072 per share from the date of the initial issuance of such share of Series B Preferred Stock.

46. Thus, at present, the Redemption Price for the 300,000 Shares is $440,730.

Recent Disclosures Prove that
China Carbon Is In Danger of Rapid Collapse

47. On April 25, 2013, China Carbon filed a Form 8-K/A ,which stated that China Carbon had dismissed its independent registered public accounting firm, BDO China Dahua CPA Co., Ltd. A true and correct copy of relevant excerpts of the April 25, 2013 Form 8-K/A is annexed hereto as Exhibit H.

48. That Form 8-K/A states in part:

> (a) During the process of auditing of the Company's consolidated statements for the year ended December 31, 2012, the **Company and BDO China Dahua disagreed with the amount of adequate audit evidence needed to support the Company's year-end accounts to meet the requirements of BDO China Dahua;** (b) the Board of Directors of the Company discussed these disagreement with BDO China Dahua; and (c) the Board of Directors of the Company has authorized BDO China Dahua to respond fully to inquiries of the successor independent registered public accounting firm concerning this matter.
>
> The disagreement between the Company and BDO were as follows:
>
> 1 **BDO China Dahua and the Company do not agree on the amount of allowance for accounts receivable.** BDO China Dahua suggested a reserve of $3.25 million bad debt allowance as of December 31, 2012. The Company believes that most of it is collectable. Due to lack of subsequent accounts receivable collections, **the Company was not able to provide supportable evidence of the accounts receivable balance.**
>
> 2 BDO China Dahua considered all the $4.76 million interest as expense because BDO China Dahua believes that the Company's loans are for working capital purpose only. The Company was not able to provide agreements showing that the loans are used for construction. The Company believes that the Company is entitled to capitalize part of the interest expenses regardless of the purpose of the loans.

3 BDO China Dahua and the Company did not agree on the Company's ability to continue as a going concern. BDO China Dahua believed there were negative financial indicators showing that the Company has a going concern issue, the Company has enormous amount of liabilities, three consecutive years with substantial negative operating cash flows, significant reliance on short-term debt and inventory notes payable. And also, the Company has decreasing revenues, decreasing profits, which causing inability to make financing interest payments. The Company's management did not agree with this assessment, but did not provide adequate evidence to support the next twelve months of operations.

Ex. H at Item 4.01 (Emphasis added).

49. On or about June 12, 2013, CNH delivered to attorneys for China Carbon a letter substantively similar to the First Notice of Breach (the "Second Notice of Breach," a true and correct copy of which is annexed hereto as Exhibit I).

50. In response, on June 17, 2013, an attorney representing China Carbon contacted CNH and stated that he had suggested that China Carbon propose an offer to settle the matter.

51. Despite that entreaty, no further contact has been made.

FIRST CLAIM FOR RELIEF
(Specific Performance)

52. Plaintiff reasserts and re-alleges the facts in each and every preceding paragraph as through fully set forth herein.

53. Plaintiff and Defendant are parties to an executed agreement.

54. Plaintiff has fulfilled all of its obligations under the agreement.

55. Plaintiff is willing and able to perform its remaining obligations, if any.

56. Defendant is able to perform its obligations.

57. Defendant has not performed its obligations.

58. As a direct and proximate result of Defendant's breach of the agreement, Plaintiff has been damaged.

59. Monetary damages are an insufficient substitute for performance under the agreement.

60. Plaintiff has no adequate remedy at law.

SECOND CLAIM FOR RELIEF
(Breach of Contract)

61. Plaintiff reasserts and re-alleges the facts in each and every preceding paragraph as through fully set forth herein.

62. Plaintiff and Defendant are parties to an executed agreement.

63. The agreement is supported by adequate consideration.

64. Plaintiff has fulfilled all of its obligations under the agreement.

65. Defendant has breached the agreement.

66. As a direct and proximate result of Defendant's breach of the agreement, Plaintiff has been damaged in an amount to be proven at trial, but not less than $440,760.

THIRD CLAIM FOR RELIEF
(Conversion)

67. Plaintiff reasserts and re-alleges the facts in each and every preceding paragraph as through fully set forth herein.

68. From December 22, 2011 onward, Plaintiff had legal ownership or a superior right to possession of personal property in the amount of the Redemption Price.

69. Defendant intentionally exercised dominion and control over the Plaintiff's personal property.

70. Plaintiff owned or had the right to possess the personal property in question at all times on and after December 22, 2011.

71. Defendant's exercise of dominion and control was to the exclusion of Plaintiff's rights.

72. Defendant's exercise of dominion and control deprived the Plaintiff of possession or use of the personal property in question.

73. Said exercise of dominion and control caused damages to the Plaintiff.

74. As a direct and proximate result of Defendant's conversion, Plaintiff has been damaged in an amount to be proven at trial, but not less than $440,760.

FOURTH CLAIM FOR RELIEF
(Declaratory Judgment)

75. Plaintiff reasserts and re-alleges the facts in each and every preceding paragraph as through fully set forth herein.

76. For the foregoing reasons, Plaintiff seeks a declaratory judgment that China Carbon is in breach of its contractual obligations under the Subscription Agreement and the Certificate of Designation.

WHEREFORE, Plaintiff demands judgment:

A. On the First Claim for Relief, mandating that China Carbon specifically perform its obligations pursuant to the Mandatory Redemption provision of the agreement;

B. On the First Claim for Relief, preliminarily and permanently enjoining China Carbon from withholding performance of its obligations under the Mandatory Redemption provision of the agreement;

C. In the alternative, awarding Plaintiff monetary damages on the Second Claim for Relief in an amount to be proven at trial, but not presently believed to be less than $440,760;

D. In the alternative, awarding Plaintiff damages on the Third Claim for Relief in an amount to be proven at trial, but not presently believed to be less than $440,760;

E. Declaring China Carbon in breach of its contractual obligations under the Subscription Agreement and the Certificate of Designation;

F. Awarding pre- and post-judgment interest on all amounts awarded to CNH hereunder at the New York State statutory rate;

G. Awarding Plaintiff its attorneys' fees, costs, and disbursements incurred in enforcing its rights in bringing this action; and

H. Awarding such other and further relief in favor of Plaintiff as this Court deems just, proper, and equitable.

Dated: July 22, 2013
New York, New York

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